No. 7484.

United States
Circuit Court of Appeals
For the Ninth Circuit.

David Gordon,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.

PETITIONER'S OPENING BRIEF.

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SUBJECT INDEX.

TABLE OF AUTHORITIES CITED.

Cases.

Statutes.

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STATEMENT OF THE CASE.

The Commissioner of Internal Revenue determined a deficiency of Twenty-six Hundred Fourteen Dollars ($2614.00) in petitioner's payment of income tax for the year 1928, and on appeal to the Board of Tax Appeals this determination was upheld by an order of the Board entered November 24, 1933.

Petitioner and his wife filed separate returns for the tax year in question, in which returns their income was divided unequally. The Commissioner denied the propriety of any division of income and arrived at the claimed deficiency by taking as a tax basis the aggregate

of all income reported by petitioner and his wife, Lillian Gordon.

The evidence consists solely of the record, the testimony of the petitioner and the income tax returns of petitioner and his wife for the year 1928. Petitioner's testimony is substantially as follows: The income reported on the 1928 returns of himself and his wife was derived from real and personal property situate in California, acquired with the proceeds of the liquidation of a business formerly carried on by himself and his wife in Canada, the liquidation having been spread over a period of several years and completed about 1924; that such business was commenced shortly after petitioner's marriage to his present wife; that at the time of said marriage, he had no property of any kind, and that the original capital of the business was furnished by his wife, being funds given to her by her father at the time of the marriage; that at the time of the marriage an oral agreement was entered into between petitioner and his wife by which all property thereafter acquired by them or either of them was to be held by them in common and that this agreement was fully consummated and adhered to from the time of the marriage to the date of the hearing before the Board of Tax Appeals (September 26, 1933); that petitioner had an inadequate education, was inexperienced in income tax matters, and relied solely upon an auditor who was a simple bookkeeper, for the preparation of the income tax returns;

that the auditor was instructed, in the preparation of the returns in question, to divide the income equally between the petitioner and his wife.

Although the Board of Tax Appeals found that the property agreement was made as claimed by the petitioner, it held that there was no pleading or proof of the pertinent law of Canada, showing either (1) that community law obtains in Canada, or (2) that it might be superseded by agreement of the parties, or (3) that husband and wife are in Canada free to contract with each other with respect to property. In the absence of such pleading and proof, the Board held that it could not determine the ownership of the property either as acquired or at the time of removal to California, and, thus, not knowing the ownership of the property in Canada, it was impossible to determine what the status of the property would be in California, whether it was separate or joint or community property, or perchance fell in some other category. It was, therefore, held to be unnecessary to determine the efficacy in law of the so-called "fifty-fifty" agreement and that, lacking proof of essential facts, the Board had no alternative but to hold that the petitioner had not established that respondent was in error in determining the deficiency, and ordered that decision be entered for the respondent. This was done.

SPECIFICATION OF ERRORS.

The questions involved, all of which were raised by assignments of error in the petition for review, are as follows:

I. The Board of Tax Appeals erred in failing to take into account as evidence the presumption that the pertinent Canadian laws are the same as the laws of California on the particular subject involved.

II. The Board of Tax Appeals erred in failing to give effect to the contract between petitioner and his wife which created a tenancy in common as to all of their property.

III. The Board of Tax Appeals erred in determining that any deficiency exists.

IV. The Board of Tax Appeals erred in holding that, under the evidence, the wife of petitioner had no separate interest in the aggregate income of the spouses.

BRIEF OF THE ARGUMENT.

A. The Law of California Permits Husband and Wife Orally to Impress Upon Property Acquired by Either or Both, the Character of Common Property.

"Either husband or wife may enter into any engagement or transaction with the other, or with any other person, respecting property, which either might if unmarried; subject, in transactions between themselves, to the general rules which control the actions of persons occupying the confidential relations with each other, as defined by the title on Trusts."

California Civil Code, Sec. 158.

"A husband and wife may hold property as joint tenants, tenants in common, or as community property."

California Civil Code, sec. 161.

The foregoing sections have been interpreted by the California courts to permit the spouses by informal contract to change the character of their property from community to separate property or *vice versa.*

"That a husband and wife may by contract change the character of their property from community to separate is well settled (*Perkins v. Sunset Tel. & Tel. Co.,* 155 Cal. 712; *Fay v. Fay,* 165 Cal. 469), likewise they may by contract transmute the separate property of either into community property. (*Yoakum v. Kingery,* 126 Cal. 30; *Carlson v. Carlson,* 10 Cal. App. 300.) No sound reason suggests itself why they may not accomplish the same purposes by contract made prior to and in anticipation of marriage. The law requires such contracts to be

in writing. Where the contract has been fully executed by one party, the case is taken out of the statute."

Martin v. Pritchard, 52 Cal. App. 720, 724.

Under the undisputed evidence here, petitioner and his wife entered into such an agreement at the time of their marriage by which all property thereafter acquired by either of them or both was to be transmuted into common property, and this agreement was renewed and adhered to when they came to California.

The law of California permitted and made effective the agreement thus renewed and regardless of the Canadian law on the subject, the agreement stands unimpaired.

B. Where the Foreign Law Is Neither Pleaded Nor Proved, the Law of the Forum Should Be Invoked.

In its memorandum opinion, the Board of Tax Appeals says:

"Petitioner failed either to plead or prove the pertinent law of Canada respecting title to property in Canada. We cannot assume it or take judicial notice of the same. Nor is quotation of such laws in the brief sufficient. The record fails to show that community property obtains in Canada, that it may be superseded by agreement of the parties, or even that husband and wife are free to contract with each other with respect to property. We are left in entire ignorance of the status or ownership of property in Canada.

"In this situation we cannot determine the ownership of the property either as acquired or at the time of removal to California. Thus, not knowing the ownership of the property in Canada it is impossible to determine what the status of the property would be in California, whether it was separate or joint or community property or perchance fell in some other category.

"It is therefore unnecessary to determine the efficacy in law of the so-called 'fifty-fifty' agreement." [Tr. p. 11, fol. 11.]

In support of its theory the Board of Tax Appeals quoted *Church v. Hubbart,* 2 Cranch 187, 236, and *Columbian Carbon Co.,* 25 B. T. A. 465.

In both cases the court refused to take notice of statutes of a foreign country not pleaded or proven. Neither case denied the familiar doctrine that where foreign laws are neither pleaded nor proven, the law of the forum will be invoked. This doctrine, however, was entirely ignored by the Board of Tax Appeals in the instant case. This universal rule is exemplified by the following citations from decisions of California courts:

"There was no evidence at all tending to show what the law was in the foreign country touching any of the questions which are raised here; and it must, therefore, be assumed that the law with respect to those matters was the same there as in California. (*Norris v. Harris,* 15 Cal. 254; *Hickman v. Alpaugh,* 21 Cal. 226; *Hill v. Grigsby,* 32 Cal. 55; *Marsters v. Lash,* 61 Cal. 624; *Monroe v. Douglass,* 5 N. Y. 447; *Liverpool etc. Co. v. Phenix Ins. Co.,*

129 U. S. 445.) This rule applies to England as well as to sister states of the American nation. In *Liverpool etc. Co. v. Phenix Ins. Co.,* 129 U. S. 445, the supreme court of the United States says: 'The law of Great Britain since the Declaration of Independence is the law of a foreign country, and, like any other foreign law, is matter of fact, which the courts of this country cannot be presumed to be acquainted with, or to have judicial knowledge of, unless it is pleaded and proved.'"

Wickersham v. Johnston, 104 Cal. 407, 411.

"In Monroe v. Douglass, 1 Selden, 452, the Court of Appeals of New York, in referring to the laws of Scotland, which were supposed to apply to the controversy involved, but which were neither asserted or proved to be different from those of that State, used this language: 'It is a well settled rule, founded on reason and authority, that the *lex fori,* or, in other words, the laws of the country to whose Courts a party appeals for redress, furnish in all cases, *prima facie,* the rule of decision; and if either party wishes the benefit of a different rule or law, as, for instance, the *lex domicilii, lex loci contractus,* or *lex loci rei sitae,* he must aver and prove it. The courts of a country are presumed to be acquainted only with their own laws; those of other countries are to be averred and proved, like other facts of which Courts do not take judicial notice, and the mode of proving them, whether they be written or unwritten, has been long established.' (See also as bearing more or less

directly on this and kindred questions, Arayo v. Currel, 1 Mill. La. 541; Crozier v. Hodge, 3 Id. 357; *Ex parte* Lafonta, 2 Rob. 495; Smoot v. Russel, 1 Mart. N. S. 522; Campbell v. Miller, 3 Id. 149; Harris v. Allnut, 12 La. 465; Greenwade v. Greenwade, 3 Dana, 75; Holmes v. Broughton, 10 Wend. 75; Abell v. Douglass, 4 Denio, 305; Thurston v. Percival, 1 Pick. 415; Crouch v. Hall, 15 Ill. 265; Titus v. Scantling, 4 Blackf. 90; Sheperd v. Nabors, 6 Ala. N. S. 637; Ellis v. White, 25 Id. 540.)"

Norris v. Harris, 15 Cal. 226, 254, 255.

C. The Contract Between Petitioner and His Wife Should Be Given Effect.

Hereinbefore we have demonstrated that a contract made in Canada and renewed in California upon arrival of the parties and fully executed by them, having for its purpose the creation of a tenancy in common as to the property of either or both, is and was lawful and effectual. The only testimony in the record is that of the petitioner.

"Prior to my marriage, we did not enter into a written prenuptial agreement but we discussed it several times that everything we made was 50-50. We did not enter into any agreement in writing. In Quebec a prenuptial agreement is usually entered into which is usually against the wife's interest in this way, that if a man would have property he would agree to give his wife—well, if he was worth a hundred thousand dollars he would agree to give his wife so much, and she would resign and waive all her community rights and her partnership rights. My wife was against anything of that nature and she said we would be 50-50. I did not enter into any

prenuptial agreement whereby my wife waived any rights in my property." [Tr. p. 17, fol. 19.]

* * * * * * * *

"The gist of the conversations with my wife was as follows:

"I could not, on any transaction that amounted to real money, do anything unless my wife agreed to it, because it was hers as much as mine.

"From the time of my marriage up to the present time, my practice with respect to either the purchase or sale of any properties has been that if the deal was advantageous to us both, and she objected to it, it wouldn't happen, that is all. It is the same right now.

"Whenever my wife wants any money, for any purpose at all, she just says 'get it' and that is all there is to it. My wife would feel highly insulted, and I would feel I was stealing it from her if I raised the question that she did not own one-half of my property, or tried to take any more than half of what was owned, in my own right, for my benefit.

"At the time when I arrived in California with funds from Canada that had been accumulated since my marriage, my wife and I considered that each of us owned one-half of that at the time of our arrival in California." [Tr. p. 18, fols. 19-20.]

* * * * * * * *

"In the earning of income my wife performed office duties. In Canada she was in the office pretty nearly every day. Whenever I had to go away on buying trips she ran the business. Even now when I go away she transacts everything and naturally she

is the mother of two children and she looks after the children." [Tr. p. 23, fols. 23-24.]

* * * * * * * *

"I had agreements with my wife, relative to the ownership of property, after we came to California. She would feel insulted if I told her she did not own one-half of what I had. Every transaction I made of any importance, that involved money, I could not do unless I got her agreement to it and if she wanted to help her relatives out she does not say 'will you?' but she says 'give it to them' and that is hers if I have it to give." [Tr. p. 23, fol. 24.]

This testimony is uncontradicted, and the pertinent finding of the Board of Tax Appeals is in accordance therewith. The finding follows:

"* * * After marriage petitioner and his wife agreed that everything was to be on a '50-50' basis. Petitioner and his wife took the $3,000 and started a small manufacturing business in men's and women's clothing. The business prospered and was continued until about 1921 when petitioner and his wife moved to California, bringing with them in excess of $200,000. This money was variously invested, much of it being lost before the taxable year. It is the income from such property that is in question for 1928." [Tr. pp. 9-10, fol. 10.]

The fact of the contract being found and its propriety under the California law being shown, the Board of Tax Appeals should have given it effect, and erred in not so doing.

D. The Board of Tax Appeals Erred in Sustaining the Determination of a Deficiency.

As appears by the statement of the Commissioner of Internal Revenue of March 9, 1931 [Tr. p. 7], the determination was based upon the refusal of the commissioner to allow a division of aggregate income between petitioner and his wife, on the theory that no part of it was common property. The theory of tenancy in common was ignored. No question as to the quantitative division between husband and wife was raised therein or on the hearing of the case before the Board of Tax Appeals. It is respectfully submitted that all of the property being owned in common by petitioner and his wife, it was proper for them to divide the income therefrom in their respective returns and that this matter should be remanded to the Board of Tax Appeals with instructions to order the re-computation of the income tax of the petitioner.

If it be contended that the petitioner is bound by the use of the words "community property" in the return filed by him for the tax year 1928, there will be remembered the confusion that existed in California for many years as to the rights of the wife in community property, particularly with regard to the income tax implications thereof, this confusion being finally eliminated by decisions of the Supreme Court of the United States.

The tendency throughout the history of California law on this subject has been to extend the present right of the wife in community property and likewise, which is most material here, to attempt to include in the community property, property acquired in other states and brought

into California. An example of this latter tendency is section 164 of the Civil Code as amended in 1917, which broadened the definition of community property by the words "including real property situated in the state, and personal property wherever situated, *acquired while domiciled elsewhere which would not have been the separate property of either if acquired while domiciled in this state.*" In *Estate of Frees,* reported in 187 Cal. 150 and decided in September, 1921, the 1917 amendment was held not retroactive. At the next session of the Legislature of California the statute was again amended for the purpose of avoiding the rule announced in the *Frees* case, the only substantial change being in substituting for the words "personal property wherever situated acquired while domiciled elsewhere," the words "personal property wherever situated heretofore or hereafter acquired while domiciled elsewhere."

On January 4, 1926, the Supreme Court of the United States decided the case of *U. S. v. Robbins* (70 L. Ed. 285), and held that under the interpretation placed by the California courts upon the pertinent statutes the wife had a mere expectancy in the community property while living with her husband, and therefore that the whole of the income of the community property was taxable to the husband alone.

In an obvious attempt to broaden the wife's present rights in community property as well as to confer upon the spouses a right to divide the community income for income tax purposes, the Legislature in 1927 added to the Civil Code, section 161-a, defining the respective interests of the husband and wife in community property

during continuance of the marriage relation as "present and existing equal interests under the management and control of the husband, as is provided in section 172 and 172-a of the Civil Code,"

> "161a. Interests in community property. The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property."

Sections 164 and 172a were in supposed force and effect at the time the 1928 return of the petitioner herein was made up and filed, and it is not surprising that the return, made up by an auditor who was instructed to divide the income on an equal basis, should have used the words "community property" in the sense of property in which both spouses had a present equal interest and the income from which might be evenly divided between them. The property consisting of the proceeds of personalty brought into California from Canada prior to 1927 and acquired in Canada under circumstances which would have made it other than the separate property of either spouse if acquired in California, it was reasonable to assume that section 164, C. C., operated to convert it into community property from its entrance into the state. Taking the cited section at its face value, this would have been its effect upon the property owned in common by the petitioner and his wife prior to its being brought into California. Such effect was given to section

164 by the Supreme Court of California in its first decision in the case of *In re Estate of Thornton,* reported in 85 Cal. Dec. 253, in which it was held that property acquired by a husband and wife in Montana prior to 1919 and brought into California was community property under the authority of section 164, Civil Code, upon the ground that, under the laws of Montana, it was the husband's separate property when acquired. On rehearing, however, the California Supreme Court, in its decision reported in 87 Cal. Dec. 711 under date of May 17, 1934, reversed itself and declared the cited portion of the code section unconstitutional, saying (p. 713):

> "The doctrine that a change of domicile to this state, accompanied by an importation of the personalty, is an implied consent to a submission to requirements of this statute, cannot be sustained, for to do so would be to give effect to a restriction prohibited by the Constitution."

It is not surprising, therefore, that in 1929 when this return was prepared and filed, the parties may have believed the property which they had acquired as tenants in common in Canada was, upon its entrance into California, converted into community property, and that the addition to the Civil Code of section 161a in 1927 permitted the division of the income from such property between the respective returns of the husband and wife. Such misunderstanding, however, almost universal as it was, should not be permitted to deprive the petitioner of an undoubted right to divide the income of the property held in common by him and his wife in accordance with the oral contract between them, that is to say, equally between them.

E. Analysis of the Income Tax Returns.

A comparative summary of the returns of petitioner and his wife for the tax year in question shows the following income:

Source	David Gordon	Lillian Gordon
3. Interest on bank deposits, etc (except interest upon which a tax was paid at source)	$ 3,905.63	$ 1,395.62
3a. Interest on tax free covenant bonds upon which a tax was paid at source	1,925.00	1,925.00
5. Rents and royalties	7,308.40	7,008.40
6. Profit from sale of real estate, etc	28,574.83	8,649.52
7. Dividends on stock of domestic corporations	2,922.88	2,922.87
9. Other income — Hugh Evans, Inc. Tract	984.00	.....
Total income	$45,620.74	$21,901.41
DEDUCTIONS		
11. Interest paid	$ 9,588.01	$ 3,363.01
12. Taxes paid	3,643.92	2,816.44
15. Contributions	640.50	.....
16. Other deductions authorized by law	3,903.75	.....
Total Deductions	$17,776.18	$ 6,179.45
	$45,620.74	$21,901.41
	17,776.18	6,179.45
Net Income	$27,844.56	$15,721.96

As to income, items 3a and 7 are identical on each return, and the accountant's reason for the equal division of these sources of income is explained by the legend "community ½" inserted by him on each return opposite these items. Regardless of the accountant's theory, he at least obeyed the petitioner's instructions as to these items.

Item 5—rents and royalties—shows petitioner's income from this source to be exactly $300 in excess of that reported by his wife. Referring to Schedule B, it appears that the $300 difference results from the allocation to the petitioner of the income from a property at 8th and Kingsley streets amounting to $300 and an equal division between petitioner and his wife of an item of $14,016.80 explained by the legend "joint tenancy ½" on each return. The accountant followed instructions as to the major item but insisted on the allocation of the entire income from the 8th and Kingsley property to petitioner's return, the logical inference being that the property stood in petitioner's name alone. Acquired as it was with the common funds of petitioner and his wife, this income should have been divided evenly between them, regardless of the record ownership.

Referring to item 3—interest on bank deposits, etc.—upon which a tax was not paid at the source, we find the petitioner reporting $3905.63, the wife, $1395.62. The explanation of the wife's return in this respect is found in Schedule F of her return, respondent's Exhibit A, by which it appears that the reported sum of $1395.62 is

made up of interest received on mortgages and trust deeds acquired since July, 1927. Opposite each appears the legend "community ½," from which the accountant's theory becomes clear. The theory manifestly was that the oral agreement was ineffectual, that the income from the property of the spouses acquired since July, 1927, was properly divisible for income tax purposes but that income from property held in the name of or dealt in by either alone was to be allocated to the particular spouse involved; also that income from property acquired by either or both prior to July 29, 1927, was to be allocated to the husband alone.

An examination of the schedule attached to petitioner's return, respondent's Exhibit B, confirms this view. The income there allocated to item 3 is shown to be made up of the sum of $1395.63, composed of one-half of the income of the same properties referred to in the wife's Exhibit F, together with $2510 received from two sources not included within the designation "property acquired since July, 1927."

The remaining item of income is 6—Profit From Sale of Real Estate, etc. The wife's return reported under this heading the sum of $8649.52, unexplained upon her return. The explanation appears on Schedule C of the schedule attached to petitioner's return where it appears that an identical amount is reported by the husband as a part of the total of $28,574.83 reported by him under item 6 and that the divided income consisted of profit on

the sale of stocks and bonds bought and sold in 1928. Again appears the explanatory legend "community one-half."

The remaining $19,925.31 of this item reported by the husband, consists of profit made in real estate and personal property transactions dating from 1925 to 1928, inclusive. The inference is that Mrs. Gordon's name did not appear in these transactions.

Mr. Gordon stated that the bank accounts and most of the real estate dealings were in his name alone. [Tr. p. 22, fol. 23.] He likewise testified that his instructions to the accountant were to divide the income, regardless of source, between the two returns [Tr. p. 20, fols. 21. 22]; also that "the returns were made according to the conception of the auditor of which the law demanded." [Tr. p. 24, fol. 24.] The reasonable inferences to be drawn from the testimony and the two returns are as follows:

1. The auditor conceived that:

   (a) The law required the allocation to the husband of all income received from transactions carried on in the name of the husband alone.

   (b) The law permitted the division between the spouses of all income from transactions after July 1, 1927.

2. The auditor disregarded the oral agreement between the spouses by which all income from whatever

source obtained was to be their common property, as well as the instructions of petitioner in conflict with the auditor's conceptions.

As to the deductions, it is apparent that interest and taxes paid were divided on the same theory, that is to say, evenly as to the property held in joint tenancy and the so called "community property," the balance being allocated to the petitioner's return. Likewise the remaining deduction, an aggregate of commissions and other expense in connection with the sales of property acquired in petitioner's name alone, was allocated to the petitioner alone.

F. Summary.

1. The income of the spouses for 1928 arose solely from real and personal property situate in California.

2. Such property was acquired with the proceeds of the liquidation of a business formerly carried on by the spouses in Canada.

3. Prior to their marriage the spouses agreed that all property acquired by them or either of them should be common property and this agreement was fully executed by both.

4. The proceeds of such business, acquired under like circumstances in California, would not have been the separate property of either spouse but would belong to them as tenants in common.

5. Upon their coming to California the spouses renewed and fully executed the common property agreement.

6. As to the property acquired in California with such proceeds, the spouses were, in California, tenants in common, each owning an undivided one-half thereof.

7. Under the circumstances the spouses were entitled to divide equally between their income tax returns their common income.

8. The determination of deficiency by the Commissioner, to-wit, that the whole income should be taxed to the petitioner, was erroneous.

It is respectfully submitted that the matter should be remanded to the Board of Tax Appeals for re-computation of petitioner's income tax in conformity with the property agreement of petitioner and his wife.

Respectfully submitted,

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Attorney for Petitioner.